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ILLINOIS POWER COMPANY

ILLINOIS COMMERCE COMMISSION

DOCKET NO. 03-0699

REBUTTAL EXHIBITS SPONSORED BY SCOTT GLAESER

MARCH 22, 2005

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REBUTTAL TESTIMONY OF SCOTT A. GLAESER

I. INTRODUCTION AND WITNESS QUALIFICATIONS

1
2 1. Q. Please state your name, business address and present position.

3 A. My name is Scott A. Glaeser; my business address is One Ameren Plaza, 1901
4 Chouteau Avenue, St. Louis, Missouri, 63103. I am currently Vice President, Gas
5 Supply and System Control for Ameren Energy Fuels and Services Company
6 (“AFS”), a wholly owned subsidiary of Ameren Corporation (“Ameren”).

7 2. Q. Please summarize your educational and employment background.

8 A. I received a Bachelor of Science Degree in Mechanical Engineering from the
9 University of Missouri at Rolla in December of 1986. From 1987 to January 1991 I
10 was a Combustion Engineer for the Granite City Steel Division of National Steel
11 Corporation (currently U.S. Steel Corporation). In February of 1991, I accepted
12 the position of Fuel Buyer for Union Electric Company (“UE”) in which I was
13 responsible for the purchase of natural gas for the company’s gas distribution
14 systems and gas-fired generation. In 1994 I was named Engineer, Gas Supply and
15 Planning, with continuing responsibilities for obtaining reliable and economical gas
16 supply, transportation and storage services for UE’s gas distribution systems and

17 gas-fired generation. During 1997 and 1998, in addition to my duties related to the
18 natural gas business, I also acted as a short-term power trader for UE. In March of
19 1998, after the merger of Central Illinois Public Service Company and UE, which
20 formed Ameren, I was promoted to the position of Supervising Engineer of Gas
21 Supply and Transportation in Ameren Services Company. In July of that year I was
22 promoted to Manager of the Gas Supply and Transportation Department. In
23 November of 2000 I was directly involved with the formation of AFS by the
24 consolidation of the Gas Supply and Transportation Department and the Fossil
25 Fuels Department. AFS is charged with managing natural gas and generation fuel
26 resources for all Ameren affiliated companies including Ameren's gas distribution
27 utilities and power generation companies. In this position, I continued with
28 management responsibilities over business activities including gas supply acquisition,
29 price hedging, transportation and storage capacity acquisition, system operations,
30 and regulatory affairs for AmerenUE, AmerenCIPS, AmerenCILCO, and
31 AmerenEnergy Generating Company. In October 2004 my function became
32 responsible for the same activities for the Illinois Power Company ("Illinois Power",
33 "IP" or "AmerenIP") gas distribution operations.

34 In October of 2004, I was promoted to my current position of Vice
35 President, Gas Supply and System Control for AFS. My current responsibilities
36 include all duties included in my previous position plus the management and

oversight of the Gas Control function and the End-User Transportation function located in Springfield, Illinois.

3. Q. Have you previously testified before the Commission?

A. Yes. I have testified either in person or through the submission of written prepared testimony before this Commission several times, most recently in ICC Docket No. 04-0294, which was the Commission proceeding which approved Ameren's acquisition of Illinois Power.

II. PURPOSE AND SCOPE

4. Q. What is the subject of your testimony in this case?

A. My rebuttal testimony is focused on Staff witness Mr. Lounsberry's proposed disallowances. Specifically, my rebuttal testimony will explain (1) the Commission's standard of prudence and the application of that standard by Mr. Lounsberry in this case, (2) Ameren's due diligence process prior to its acquisition of Illinois Power, specifically with respect to IP's gas storage fields; and (3) Ameren's reasons for negotiating indemnification provisions with respect to certain gas-related matters in the Stock Purchase Agreement with Dynegy Inc. for the acquisition of IP. Other AmerenIP witnesses – Messers. Shipp, Hood, Kemppainen and Hower - provide detailed testimony responding to the specific issues raised by Mr. Lounsberry in his direct testimony.

III. STANDARD OF PRUDENCE

57

58 5. Q. What is your understanding of the Commission's standard of prudence?

59 A. It is my understanding that the Commission has adopted the following standard of
60 prudence:

61 Prudence is that standard of care which a reasonable person would
62 be expected to exercise under the same circumstances encountered by
63 utility management at the time decisions had to be made. In determining
64 whether a judgment was prudently made, only those facts available at the
65 time judgment was exercised can be considered. Hindsight review is
66 impermissible.

67 Imprudence cannot be sustained by substituting one's judgment for
68 that of another. The prudence standard recognizes that reasonable persons
69 can have honest differences of opinion without the one or the other
70 necessarily being "imprudent." (Illinois Commerce Commission v.
71 Commonwealth Edison Co., Docket 84-0395 (Order issued Oct. 7,
72 1987), p. 17)

73 It is also my understanding that the Commission as well as the Illinois courts have
74 recognized that human errors are unavoidable and that the commission of some
75 errors in an activity does not necessarily mean that a utility was imprudent (e.g.,
76 Order in Docket 84-0395, p. 19).

77 6. Q. Do you believe that Mr. Lounsberry is properly applying the prudence standard in
78 recommending his proposed disallowances in this case?

79 A. No, I do not. First, I believe Staff witness Lounsberry's opinions that IP was
80 imprudent in the actions it took to investigate the decline in deliverability of its
81 Hillsboro Storage Field ("Hillsboro" or "HSF") and the two instances of

82 unauthorized overrun charges in 2003 are based on hindsight and do not adequately
83 take into account the circumstances faced by IP at the time the decisions and
84 actions at issue were being made. His recommendations are based on an after-the-
85 fact analysis of what he thinks IP should have done or should have known based on
86 certain information (to the exclusion of other information that IP had to take into
87 account) at particular points in time. Mr. Lounsberry also greatly oversimplifies the
88 difficulties associated with evaluating the multiple potential causes of the Hillsboro
89 deliverability problems and eliminating potential causes to arrive at the actual cause
90 or combination of causes. His analysis fails to adequately take into account that
91 underground storage reservoirs such as Hillsboro are complex geological systems
92 whose characteristics cannot be known with complete certainty. AmerenIP
93 witnesses Hood, Kemppainen and Hower address these topics in detail in the
94 context of the Hillsboro-specific issues. Finally, in some respects Mr. Lounsberry
95 is holding Illinois Power to a standard of absolute perfection. This is most apparent
96 in his proposed imprudence disallowances for unauthorized pipeline overrun
97 charges, which occurred on two days out of 365 days in the reconciliation year and
98 constituted a fraction of one percent of the gas entering IP's system on that day.
99 Again, Mr. Lounsberry greatly oversimplifies the operation of natural gas utilities
100 which are vast, complex systems covering large geographic areas driven by
101 constantly changing weather conditions and the individual choices of hundreds of

102 thousands of gas consumers. To demand perfection in the management and
103 operation of such complex and variable systems is unrealistic and unreasonable.

104 7. Q. Do you have any other concerns about Mr. Lounsberry's application of the
105 prudence standard in this case to produce his proposed disallowances?

106 A. Yes. I believe that Mr. Lounsberry's recommended imprudence disallowances
107 introduce a level of risk to the gas distribution business that is inconsistent with the
108 level of reward that AmerenIP has the opportunity to earn from this regulated
109 business. For example, in 2003 IP had total purchased gas costs of over \$337
110 million, which is equal to about 74% of IP's total gas utility operating revenues.
111 Illinois Power earns no return on the sale of this gas to customers and earns no
112 return for acquiring this gas for its customers. IP's return on its gas utility business is
113 earned only from the allowed rate of return applied to its assets included in rate
114 base. In 2003, Illinois Power had net gas utility income of approximately \$20.1
115 million, which represented only about a 4.4% margin on its gas operating revenues.
116 Mr. Lounsberry's proposed imprudence disallowances of more than \$7.6 million in
117 this case represent about 38% of IP's total gas operating income. Thus, Mr.
118 Lounsberry's proposed disallowances impose a very substantial risk of loss on IP's
119 relatively modest rewards from the gas utility business.

120

IV. AMEREN'S PRE-ACQUISITION DUE DILIGENCE

120

121 8. Q. Beginning at the bottom of page 50 of his direct testimony, Mr. Lounsberry quotes
122 from a "due diligence" report prepared by Ameren in connection with its
123 investigation of whether to acquire Illinois Power. Are you aware of the report he
124 cites?

125 A. Yes, I am. I was part of the Ameren acquisition team that was responsible for
126 performing due diligence during Ameren's investigation and negotiations concerning
127 the possible purchase of Illinois Power from Dynegy. In fact, I was the co-author
128 of the specific document Mr. Lounsberry quotes, "Due Diligence Analysis of Illinois
129 Power's Gas Supply and System Operations".

130 9. Q. Mr. Lounsberry states that it is his opinion that Ameren's own due diligence report
131 verifies his conclusion that "IP is unwilling to spend capital on its storage activities"
132 (Staff Exhibit 2.00, page 51). Do you agree with his assessment?

133 A. No, I do not, for several reasons. First, the due diligence process is a difficult
134 process with several purposes from the potential buyer's perspective. A primary
135 purpose is to identify and quantify as many negatives and concerns as possible
136 about the company or assets under consideration for purchase, as a basis for
137 negotiating the acquisition price or to terminate the acquisition. In addition, all
138 possible risk exposures must be identified and analyzed with limited time and
139 incomplete information in order to determine the maximum possible risk scenario,

140 even if the risks turn out later to be minor or nonexistent. Of course the selling party
141 wants just the opposite and in an attempt to “protect” its positions seeks to limit the
142 potential purchaser’s due diligence process by limiting the scope of the investigation
143 and access to its assets, records and personnel. In the same paragraph from the
144 due diligence report in which Mr. Lounsberry extracted the sentence addressing
145 IP’s capital expenditures on storage that he quoted was another sentence that
146 described the short and restricted nature of the due diligence process with Dynegy.
147 The additional sentence reads: **BEGIN CONFIDENTIAL**

148
149 **END**

150 **CONFIDENTIAL** This statement makes clear that the limited amount of
151 information, time, and access to key personnel available to Ameren’s acquisition
152 team by Dynegy resulted in an imperfect understanding of the operating risks and
153 capital expenditures associated with the Hillsboro Storage Field and Illinois Power’s
154 other storage fields. The end result is that “due diligence” conclusions are based on
155 incomplete or imperfect information, but they are made with the objective of
156 providing a basis for disclosing all potential risks and facilitating the negotiation of a
157 favorable purchase price. The statement from the due diligence report quoted by
158 Mr. Lounsberry must be considered with that context in mind.

159 10. Q. Post close, what is your current opinion of IP’s historic capital spending practices at

its storage facilities?

A. Detailed integration of Illinois Power into Ameren began immediately after the September 30, 2004 close of the acquisition. At that time, Ameren management began to have full access to Illinois Power's assets, personnel and records. The detailed integration activities uncovered no evidence that IP's capital spending at its gas storage fields has been inadequate. In fact, examining the total expenditures for the storage fields, which includes capital and O&M expenses, reveals relatively stable total expenditures with some variations due to larger capital projects in certain years (replacement of major equipment such as generators or reboilers). These expenditure variations are to be expected when managing complex physical assets with large mechanical components which are replaced from time to time, but not every year. There was no evidence of needed capital projects that were rejected or deferred due to capital spending constraints and no evidence that capital projects were not implemented in a timely manner.

**V. DYNEGY INDEMNIFICATION IN STOCK
PURCHASE AGREEMENT**

11. Q. Beginning at line 1267 (page 61) of his direct testimony, Mr. Lounsberry introduces some additional evidence that he deems "pertinent" to this case, specifically, the existence of an indemnification clause in the Stock Purchase Agreement between Ameren and Dynegy for the acquisition of IP. Mr. Lounsberry states that Ameren

180 included this provision in the Stock Purchase Agreement because “it was so
181 concerned about the manner that IP and Dynegy had operated the field”. Is his
182 assessment accurate?

183 A. No, it is not. First, the inclusion of an indemnification provision in an acquisition
184 agreement is the product in part of the uncertainties inherent in the due diligence
185 process, as I have described, as well as uncertainties concerning the outcome of
186 litigation that is pending or may result from events prior to the acquisition date.
187 Indemnification provisions in acquisition agreements are commonly used as a way
188 for the parties to share or allocate the risks associated with such uncertainties.
189 There are of course other methods that can be used to share or allocate such
190 uncertainties including agreeing to a lower purchase price, providing additional
191 working capital adjustments, or giving up indemnification rights in return for other
192 unrelated consideration. Of course, the resulting final acquisition agreement is the
193 product of extensive, arms’-length negotiations. In this case, the parties negotiated
194 to have an indemnification provision covering specific litigation and regulatory
195 matters as opposed to one of the alternative approaches.

196 I note that Mr. Lounsberry has quoted only a small portion of the
197 indemnification provision in the Stock Purchase Agreement. The indemnification
198 section of the Stock Purchase Agreement is more than seven pages long, not
199 including attachments. Additionally, one of the schedules referenced in the

indemnification section lists over 40 pages of potential litigation exposure. These indemnifications of potential risk exposures cover all aspects of IP's utility business including environmental issues, tax issues, outstanding lawsuits, warranties, and representations by the Seller. Mr. Lounsberry's attempt to isolate one indemnification clause from this extensive list of indemnifications as evidence of imprudence on the part of IP is misleading and misrepresents the purpose of indemnification clauses.

12. Q. Why were the open PGA cases and the Hillsboro Storage Field inventory issue specifically identified in the indemnification provision in the Stock Purchase Agreement?

A. With respect to the open PGA cases, Ameren did not think it should bear 100% of the risk of possible disallowances in the open reconciliation proceedings relating to reconciliation periods prior to the closing of the acquisition while IP was under the control of Dynegy. With respect to the provisions relating to Hillsboro Storage Field, at the time we were negotiating to acquire IP (late 2003-early 2004), Illinois Power had recognized that an inventory adjustment was necessary at Hillsboro and that some portion of the base gas had probably been withdrawn and supplied to customers, but IP had not finally determined the actual amounts or the plan for recovery. Our concerns focused on the risks associated with obtaining cost recovery in future periods for the consequences of past events.

220 Finally, I would place a different construction on the indemnification
221 provision than does Mr. Lounsberry. Specifically, Ameren was sufficiently
222 unconcerned about risks associated with the open PGA cases and the Hillsboro
223 Storage Field issues that it was willing to agree to a 50-50 sharing of those risks
224 with Dynegy rather than insisting that Dynegy bear 100% of the risks.

225 13. Q. Does this conclude your prepared rebuttal testimony?

226 A. Yes, it does.